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TAGS: [EFIN](#) [GM](#) [AU](#)

SUBJECT: Hypo Alpe Adria Group's Future Unclear Amid Allegations of
Widespread Fraud and Misconduct

REF: A) 09 Vienna 1583; B) 09 Vienna 1479

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Sensitive but unclassified -- protect accordingly.

[11](#). (SBU) SUMMARY: Investigations into the nationalized Hypo Alpe Adria banking group (HAA) are likely to have significant legal and political implications in Austria and beyond. Following the December 14 GoA takeover of HAA (Austria's sixth largest banking group with pre-crisis assets of about EUR 43 billion), criminal investigations are underway and media revelations abound concerning insider profiteering, widespread leasing fraud, illegal party financing, poor risk management, and offshore speculative losses. The role of Austrian insider and later HAA CEO Tilo Berlin -- who helped prominent investors make a fast buck in the weeks leading to BayernLB's takeover in 2007 -- is under criminal investigation in Germany. The GoA downplays BayernLB's legal prospects of recovering funds from the 2007 takeover. Recent reports suggest the HAA faces significant problems in southeast Europe. Austria's Ministry of Finance/MoF will likely downsize HAA radically by selling some foreign divisions and closing others. END SUMMARY.

[12](#). (SBU) This cable overviews the myriad allegations against HAA and the status of investigations in Austria (NOTE: we understand German prosecutors are hot on the case as well). Since the GoA nationalized HAA in December (to avert a potential run on the bank), media reports have described insider trading in the course of HAA's sale to BayernLB in 2007, leasing fraud, offshore losses, and a variety of issues in southeast Europe including poor risk management, and questionable political ties.

Criminal Investigation Progressing Slowly?

[13](#). (SBU) Criminal investigations in Austria began with the December 14 nationalization of HAA, but (unlike in Germany) appear to be proceeding slowly. Austrian business leaders including Claus Raidl (a steelmaker who also serves as President of Austria's central bank, the OeNB) and Hannes Androsch (co-head of FIMBAG, which leads the GoA's bank rescue effort) have criticized the slow handling of the case and called on the GoA to put more resources into the investigation. Apparently the case is being led by a single prosecutor in Klagenfurt (HAA's "home base"): both Raidl and Androsch called on the GoA to move the investigation out of Carinthia, given that state's close ties to HAA leadership.

[14](#). (SBU) On January 14, an investigative committee in Carinthia's provincial parliament began looking into HAA's sale to BayernLB. Austria's coalition parties SPOe and OeVP have agreed to rely on that committee's findings and have no plans to establish a

fact-finding committee in the federal Parliament. So far, none of the major players in HAA management, the Carinthian government, or the Carinthian Provincial Holding Company (which held HAA shares on behalf of the province) has resigned. FinMin Josef Proell is expected to announce personnel changes at HAA sometime after January 18.

Leasing Fraud, Alleged Party Financing

15. (U) Austrian prosecutors are reportedly also investigating fraud in HAA leasing transactions. Media reports say hundreds of luxury yachts and cars "disappeared" from HAA's leasing business in the Balkans; reportedly, 100 leased cars were stolen even before HAA acquired them (i.e. their registration papers were forged prior to HAA acquiring them). HAA's loan business in the Balkans (see below) had similar gaps: country managers allegedly provided loans without evaluating risks or requiring appropriate collateral. Other press reports point out that HAA lost several hundred million Euros in Lehman, Iceland, and other toxic paper invested via offshore funds on Jersey Island (however, those losses were publicly known prior to HAA's takeover).

16. (U) A leading Austrian weekly has alleged that two political parties (the BZO and OVP) got large kickbacks from the 2007 sale to BayernLB, a charge that both parties flatly deny.

Insider Trading On Behalf of Prominent Industrialists?

17. (SBU) The role of prominent investors led by Austrian financier Tilo Berlin (reportedly a close associate of BayernLB CEO Werner Schmidt since the mid-1990s) is also under investigation for insider trading. Mr. Berlin led a group of prominent Austrians

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industrialists -- reportedly including paper magnates Veit Sorger and Michael Groeller, furniture retailing CEO Herbert Koch, and representatives of the Flick, Tilly, and Senger-Weiss family fortunes -- who from December 2006 to March 2007 subscribed to an HAA equity increase, obtaining a 9.1% share in the bank. In March 2007, BayernLB CEO Schmidt was authorized to make a takeover offer for HAA; then-HAA CEO Wolfgang Kulterer was in contact with BayernLB regarding the takeover, but Kulterer was also on the board of a private trust belonging to one of Berlin's investors. Thus, Tilo Berlin may have had inside information on BayernLB's plans when he negotiated with HAA stakeholder GRAWE to raise his investors' stake to 25% plus one share. In April, BayernLB loaned Mr. Berlin EUR 300 million to buy a 16.5% stake in HAA from GRAWE (when BayernLB took over 50% plus one share in May 2007, it bought the Berlin group's 25% stake). Berlin's group ended up with a profit of EUR 150 million from a six-month investment, much of which was leveraged by BayernLB. In June 2007, Tilo Berlin was appointed CEO of HAA.

Bavarian Attempts to Claw Back BayernLB Losses

18. (SBU) BayernLB's engagement in HAA cost the bank (and now the state of Bavaria) at least EUR 4 billion, including the EUR 1.63 billion it paid for a 50% plus one share in May 2007 (NOTE: at the time, BayernLB valued HAA at EUR 3.3 billion, while many experts pegged HAA's worth at only EUR 1.8-2.5 billion). BayernLB and the Bavarian state government (its current majority owner) are considering legal action to recover money from HAA's former owners, claiming fraud. Absent a detailed legal analysis, BayernLB's chances are difficult to assess, but Austrians point to several factors weighing against damage claims:

- a 2006 OeNB report cited problems at HAA;
- the Austrian press frequently cited governance problems at HAA;
- Ernst & Young's due diligence report, although positive overall, was critical of HAA's problematic loan portfolio in Bosnia and Croatia and the unclear risks in its leasing portfolio;
- the 2007 purchase contract reportedly stipulated that BayernLB took over HAA with all risks.

An Austrian MoF contact opined to us that Bavarian efforts to recover money (either from the state of Carinthia or the GoA) have

no chance.

Problems in Southeast Europe

19. (U) Media reports suggest the bank has extensive problems in southeast Europe, on top of the leasing fraud detailed above. In Croatia, the bank is alleged to have cultivated high-level favor through loans to political figures including former defense official Vladimir Zagorec (later convicted of corruption) and Zagreb mayor Milan Bandic; Austrian media have also linked the Hypo group to scandal-ridden ex-prime minister Ivo Sanader. Hypo's business in Slovenia (with a balance sheet of EUR 2.3 billion in 2008, not including some leasing assets) is reportedly beset with similar issues.

GoA Likely to Sell Foreign Subsidiaries

10. (SBU) Austria's MoF is working on a restructuring plan for Hypo Alpe Adria, with details to be announced sometime in March. MoF contacts say the government is still assessing HAA's situation, but is likely to downsize HAA radically into a local Austrian bank by selling its (relatively) profitable businesses in Croatia, Slovenia and Northern Italy and by liquidating its operations in Bosnia-Herzegovina, Montenegro, and Serbia. HAA's leasing business will be wound down as quickly as practicable.

COMMENT

11. (SBU) In retrospect, the rapid rise of Hypo Alpe Adria from a mid-sized Carinthian bank to a Balkan mini-empire appears rooted in highly risky business practices and aggressive pursuit of political favor. The case speaks to regulatory forbearance in Austria, where regulators reportedly knew of HAA's weaknesses but did not want to rock the boat. While the HAA scandal remains a central European story -- with few ties to the broader financial crisis -- the unraveling of Hypo Alpe Adria could tarnish a number of prominent economic and political figures in Austria and elsewhere. END COMMENT.

12. (U) This cable was coordinated with ConGen Munich/Embassy Berlin

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and Embassy Zagreb.

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